No. 220

In the Supreme Court of the United States

OCTOBER TERM, 1969

JEFFERSON STANDARD LIFE INSURANCE COMPANY,
PETITIONER,

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The findings of fact and conclusions of law of the district court are reported at 272 F. Supp. 97. The opinion of the court of appeals is reported at 408 F. 2d 842.

JURISDICTION

The judgment of the court of appeals was entered on March 13, 1969. The petition for a writ of certiorari was filed on June 10, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether, in determining the income of a life insurance company, the total amount of deferred and

uncollected premiums must be included in its "gross amount of premiums" under Section 809(c)(1) of the Internal Revenue Code of 1954 without the offset petitioner claims for an amount that it calls "increase in loading on deferred and uncollected premiums."

2. Whether a life insurance company must include the total amount of deferred and uncollected premiums as assets under Section 805(b)(4) of the 1954 Code without the adjustment petitioner claims for an amount that it calls "loading on deferred and uncollected premiums."

3. Whether a life insurance company, in computing its "taxable investment income," must include the full amount of policy loan interest received or capitalized during the taxable year.

4. Whether agents' debit balances are assets of the company under Section 805(b)(4) of the 1954 Code.

5. Whether charitable contributions are deductible only in the computation of gain from operations under Section 809(d)(12) as limited by Section 809(e)(3) of the 1954 Code, or whether a portion may be deducted under Section 804(c)(1) as a general investment expense in computing taxable investment income.

6. Whether amounts designated by petitioner for future benefits which it might pay under its own Branch Office Manager's Supplemental Retirement Plan are includible as life insurance reserves under Section 801(b) of the Internal Revenue Code of 1954.

7. Whether petitioner must take into account the stock and dividends of its wholly owned subsidiary in

computing its exclusion attributable to the total policyholders' share of consolidated investment income.

8. Whether a life insurance company electing to file a consolidated income tax return was subject to the additional 2 percent tax required of corporations filing consolidated returns for the years in controversy (1958–1959).

9. Whether computations made on the Annual Statement promulgated by the National Association of Insurance Commissioners are binding upon the Commissioner of Internal Revenue—or whether they may only be used for tax purposes when consistent with the substantive provisions of the 1954 Code, as amended, and established rules of tax accrual accounting.

STATUTES AND REGULATIONS INVOLVED

Relevant provisions of the Internal Revenue Code of 1954, as amended by Section 2 of the Life Insurance Company Income Tax Act of 1959, P.L. 86–69, 73 Stat. 112, and the applicable Treasury Regulations are set forth in the petition. (Pet. 94a–126a.)[1] Section 809(d) of the 1954 Code is set forth in full in the Appendix, *infra*, pp. 40–42.

INTRODUCTORY STATEMENT

Petitioner, Jefferson Standard Life Insurance Company, and Pilot Life Insurance Company, its wholly owned subsidiary, are domestic life insurance companies taxable under the Life Insurance Company

[1] "Pet." references are to the Petition for Certiorari and the Appendix thereto. "R." references are to the printed record filed in the Court of Appeals.

Income Tax Act of 1959 (Sections 801 through 820, or Part I of Subchapter L of Chapter 1 of the Internal Revenue Code of 1954, as amended) (Pet. 41a). The Act provides that the taxable income of a life insurance company includes the full amount of its "gain from operations" up to the amount of its "taxable investment income," plus one-half of any additional "gain from operations" (Section 802(b)). "Taxable investment income" and "gain from operations" are each the result of detailed calculations and are defined in Sections 804(a) and 809(b), respectively. A description of the calculations performed in determining tax liability under the Act is contained in *United States* v. *Atlas Life Ins. Co.*, 381 U.S. 233.

Jefferson filed consolidated income tax returns in behalf of itself and Pilot for 1958 and 1959 (Pet. 41a–42a). Petitioner thereafter filed suit for refund of income taxes paid for those years. The Government filed a counterclaim for each of the years, asserting liability for additional income taxes (Pet. 43a). The issues were tried before the United States District Court for the Middle District of North Carolina. The court found for petitioner on some issues and for the Government on others. On cross-appeals, the Fourth Circuit affirmed all issues appealed by petitioner and reversed two of the three issues appealed by the Government.

Petitioner now raises nine legal issues relating to the determination of its tax liability under the Life Insurance Company Income Tax Act of 1959. Eight are the questions of statutory interpretation which

the court of appeals decided adversely to petitioner. The first two involve the proper treatment of the amounts petitioner calls "increase in loading" and "loading" on "deferred and uncollected premiums." The third involves the treatment of prepaid and capitalized interest on policy loans. These most important of the issues raised were presented to the Court in the petition for a writ of certiorari in *Franklin Life Insurance Co.* v. *United States*, No. 780, October Term 1968, certiorari denied, 393 U.S. 1118. The other five questions involve the treatment of the companies' agents' "debit" balances, their charitable contributions, amounts put aside for future retirement benefits for branch office managers, dividends which Pilot paid to the petitioner, as well as stock of Pilot held by petitioner, and the rate applicable for the consolidated return for the years in issue. With respect to two of these other issues, as well as to the loading and unearned income issues, petitioner makes the broad general assertion that the treatment of the item on the Annual Statement promulgated by the National Association of Insurance Commissioners is binding upon the Commissioner of Internal Revenue and must be followed for tax purposes. It is on this last contention that petitioner's concepts of the significance of this case largely rest.

These questions present a series of essentially independent problems of statutory interpretation. With a view to simplifying this brief, we shall separately set out and discuss the facts and legal issue relating

to each problem. On none of them is there a conflict of decisions among the courts of appeals. None of the questions presents any basis for further review.

SPECIFIC STATEMENT AND ARGUMENT

1. DEFERRED AND UNCOLLECTED PREMIUMS

Statement. In determining the income tax of a life insurance company, the calculation of "gain from operations" under Section 809 of the Internal Revenue Code of 1954, as amended, and of "taxable investment income" under Section 804, requires a determination of a life insurance company's "gross amount of premiums" during the taxable year. In calculating "gain from operations," the gross premiums constitute part of the basic figure—*i.e.*, that comparable to "gross receipts" or "gross income"—from which "gain from operations" is computed by subtracting statutorily defined deductions. In determining "taxable investment income," the gross premiums are included in the company's "assets," which control the fraction of investment income that is deemed "taxable."

The "gross annual premium" on a life insurance contract is the consideration the insured pays for a year's coverage; each premium covers an annual period beginning on the date of issuance or a subsequent anniversary date. The "net valuation premium" is the part of the "gross annual premium," computed on the basis of State required interest and mortality tables, that must be added to reserves for policyholders in each policy year. Petitioner refers to the

difference between the "gross annual premium" and the "net annual valuation premium" as the "loading." (Pet. 23a.) The district court found that there was no relation between the "loading" and expenses incurred during the policy year (Pet. 72a).

Deferred and uncollected premiums are portions of gross annual premiums (on policies in force at the end of the taxable year) which have not been collected, either because the gross annual premium is being paid in installments over the policy year, or the premium is due but unpaid (a grace period having been provided in the policy) (Pet. 23a–24a). Where payment of part of the premium has been deferred, the premium is increased by an amount designed to compensate petitioner for the loss of interest on the deferred portion of the premium, and for the added cost of servicing the account (Pet. 70a).

Petitioner accrues its reserves on the basis of the assumption that the *full* annual premium is received on the anniversary date of every policy in force, whether or not the full premium has been paid as of that date (Pet. 24a). This method of calculating reserves has a threefold effect in decreasing petitioner's tax base: (1) it increases the reserves which petitioner is entitled to deduct under Section 809(d)(2) in calculating gain from operations; (2) by reason of Section 809(a)(2), it increases the fraction of investment income that is excluded from tax under Section 809(a)(1); and (3) it increases the reserves used in determining the policyholders' share of investment income, which, under Section 804(a)(1), is also excluded from tax.

The Treasury Regulations, Sections 1.805–5(a)(4)(ii) (Example 1) [2] and 1.809–4(a)(1)(i),[3] expressly require the inclusion of deferred and uncollected portions of premiums in the calculations of both gross premiums and assets. Petitioner apparently claims an

[2] Sec. 1.805–5 *Adjusted reserves rate and earnings rates.*

(a) *In general.* * * *

* * * * *

(4) *Assets*—* * *

* * * * * * *

(ii) *Illustration of principles.* * * *

Example (1). Included in the statement of assets of P, a life insurance company, are the following items: Bonds, stocks, mortgages, home office and branch office buildings owned and wholly occupied by the company, furniture and equipment owned by the company and used in the home office and branch office buildings occupied by the company, agents' debit balances, *premiums deferred and uncollected and premiums due and unpaid*, bank deposits (including time deposits), and share accounts in savings and loan associations. * * * [Emphasis added in Example.]

* * * * * *

(26 C.F.R., Sec. 1.805–5.)

[3] Sec. 1.809–4 *Gross amount.*

(a) *Items taken into account.* For purposes of determining gain or loss from operations under section 809(b)(1) and (2), respectively, section 809(c) specifies three categories of items which shall be taken into account. * * * * * * The * * * three * * * items taken into account are:

(1) *Premiums.* (i) * * * The term "gross amount of all premiums" means the premiums and other consideration provided in the insurance or annuity contract. * * * *Such term includes advance premiums, premiums deferred and uncollected and premiums due and unpaid,* * * *. [Emphasis added in last sentence.]

* * * * * * *

(26 C.F.R., Sec. 1.809–4.)

adjustment—*i.e.*, a deduction or exclusion[4]—for an amount called "loading" in determining its "gross amount of premiums" under Section 809(c)(1) and its "assets" under Section 805(b)(4). Essentially, petitioner would calculate its net valuation premium (*i.e.*, the addition to reserves), subtract that from the gross annual premium, label the remainder "loading," and offset against the gross premiums the part of "loading" petitioner deems allocable to the deferred part of the premium. The end result is to include only the portion of the gross premium that has in fact been paid plus the part of the deferred portion that is included in reserves.[5]

The court of appeals affirmed the district court's rejection of petitioner's contentions. It held that (1) if a life insurance company calculated the deduction Section 809(d)(2) allows with respect to reserve

[4] Petitioner strongly asserts that what it seeks is an "adjustment" for loading, rather than a "deduction" and seeks to distinguish *Franklin Life Insurance Co.* v. *United States*, 399 F. 2d 757 (C.A. 7), certiorari denied, 393 U.S. 1118, on the ground that there the taxpayer mistakenly labelled the relief sought a "deduction" (Pet. 19–20.) However, petitioner urged below that the Regulations requiring reporting of gross premiums including loading are not inconsistent with its position since it only thereafter claims an offset or "deduction." (Court of Appeals Br. 35–36.)

[5] Petitioner follows the treatment provided on the annual statement form of the National Association of Insurance Commissioners, which petitioner must file annually in the States where it does business. The annual statement form is intended to demonstrate the solvency of the company, using purposely stringent and conservative accounting standards designed to show an assumed net worth upon liquidation of the company. (Pet. 14a; R. 88, 226.)

liabilities on the basis of a full year's net valuation, even though it had not received and had no legal right to receive all of the premiums therefor, it should be required to include gross annual premiums, including loading, as the gross income figure under Section 809(c)(1), and (2) if the full annual net valuation premium is treated as a reserve liability in determination of the policyholders' share exclusion under Section 804, the corresponding asset should be the gross annual premium; otherwise the formula would be unbalanced and provide the company with an unwarranted benefit.

Argument. The court of appeals did not, as petitioner seems to claim (Pet. 19), base its decision on the premise that deferred and uncollected premiums are always or necessarily accruable in income. Rather, it found that inclusion of the *gross* annual premium (including the deferred and uncollected portion) in "gross amount of premiums * * * on * * * contracts" pursuant to Section 809(c)(1) reasonably follows from the inclusion in reserves, which are deductible under Section 809(d)(2), of the annual valuation premium, which is itself calculated on the assumption that the full gross premium has been received (Pet. 26a–27a; see also district court findings No. 128, 146 and 147 at Pet. 71a, 75a.) The court then correctly found that although deductions which may be taken are spelled out in Section 809(d), no "adjustment," "deduction," or "offset" is provided for "loading on deferred and uncollected premiums." Nor did the court below hold, as petitioner also as-

serts (Pet. 19), that the amount of the net valuation premium bears a fixed mathematical relationship to the amount of the gross premium. Rather, the court reasoned that whatever that numerical relationship might be, Congress did not intend different standards to govern the calculation of includible gross premiums and deductible reserves. The record does not show the net effect on petitioner's tax liability of decreasing both its reserves and its gross premiums by the amount allocable to deferred and uncollected premiums unpaid at the end of each taxable year in issue here.

As the court below recognized (Pet. 26a–27a), the proper treatment of deferred and uncollected premiums depends on the meaning of the statute's references to "the gross amount of premiums" in Section 809(c)(1). Although the statute does not further define this phrase, Congress, as the court of appeals recognized, was aware of the accounting practices of the insurance industry, under which life insurance companies, in accounting for their gross premiums, include the full year's premium as of the anniversary date of each policy. There is no reason to suppose that Congress thought the same assumption would not be made in defining the phrase "gross amount of premiums" it used in the statute.

The basic answer to petitioner's contentions is that Congress has not provided an exemption or deduction for "loading" or the like. Although Subchapter L of the Code is filled with detailed provisions which define a number of allowable exclusions and

deductions in computation of the income tax liabilities of life insurance companies, not one refers, directly or indirectly, to "loading" or "increase in loading." It is no less true here than in any other tax case that exclusions and deductions must have an explicit statutory basis, and, as the court of appeals recognized here (Pet. 27a), the absence of such a statutory provision is fatal to petitioner's claim.

The net effect of allowing petitioner the "adjustment" it claims would be a substantial tax windfall. As Congress was fully aware (see S. Rep. No. 291, 86th Cong., 1st Sess., pp. 6–7), "loading" includes whatever profits petitioner might realize from the particular gross premium. Therefore, the effect of petitioner's claimed offset would be to defer tax indefinitely on part of its first year's profit on policies having deferred premiums. In the first policy year, petitioner would take deductions for all expenses incurred during the taxable year,[6] a full year's reserve on the policy, and the loading deduction claimed here. In later taxable years, the first year's loading deduction would not be recovered into income, for loading on the deferred and uncollected portion of the premium would remain constant and petitioner would deduct expenses in fact incurred in succeeding years. As the district court recognized here (Pet. 72a–73a), "The only point at which the additional deduction

[6] Petitioner receives deductions under Section 809(d) for all actual insurance expenses incurred. Moreover, the district court found that there was no relationship between any amount claimed deductible as "loading" and expenses for any given year. (Pet. 72a.)

would be recovered for tax purposes would be in the last year of the policy, or in the event the terms were changed so as to provide for no more deferred payments; * * *. In the case of a stable or growing company, such overall deductions would not be recoverd for tax purposes * * * until some indefinite time in the future."

The defects in petitioner's position are particularly apparent with respect to the "Phase I" determination of its assets. It is an elementary principle of accrual accounting that assets and liabilities must be related in point of time.[7]

This accounting rule is the essence of "Phase I," which is grounded in the *proportionate* relationship (see *Franklin Life Insurance Co.* v. *United States*, 399 F. 2d 757 (C.A. 7), certiorari denied, 393 U.S. 1118) between reserve liabilities, *i.e.*, assets held for policyholders, and total assets.[8] There is no indication that Congress intended a departure from the general rule in this tax formula—a departure which would allow petitioner to accrue as a liability the full an-

[7] For example, it is established that a taxpayer who accrues the cost of goods sold must also accrue in his income the full amount of receivables attributable to the sales even if payment has in fact not been made. See *Charles C. Lewis Co.* v. *United States*, 14 F. Supp. 471 (Mass.).

[8] In simple form the Phase I formula may be expressed as

$$\frac{\text{Investment yield}}{\text{Assets}} \times \text{Reserves} = \text{Policyholders' Exclusion}$$

or as

$$\frac{\text{Assets held for reserve purposes}}{\text{Total assets}} \times \text{Investment yield} = \text{Policyholders' Exclusion}$$

nual reserve for insurance coverage but then not show as an asset the full amount of the annual premium which gives rise to the liability.

The only support for petitioner's claim is that the treatment it seeks is allowed for National Association of Insurance Commissioners (NAIC) annual statement purposes. That form, however, was designed to show the financial strength of a life insurance company, using stringent and purposely conservative standards for the purpose of demonstrating the company's strength upon liquidation. That purpose requires a minimization of income and assets, an objective alien to the function of the income tax laws.[9]

Furthermore, the NAIC approach, in line with its basic objective, shows the greatest possible liabilities on the reserve side, while reflecting only the amount of deferred and uncollected premiums equal to the reserves included with respect to those premiums. This case, however, is concerned with a tax formula which relies upon the proportionate relationship between assets and reserves in determining the amount of investment income that is to be excluded from petitioner's tax base. For these purposes, as the court of appeals stated in *Franklin, supra,* p. 761, the company cannot use "an admittedly overstated reserve while at the same time allowing an accounting entry with respect

[9] The life insurance industry's own Joint Committee on Blanks of the American Life Convention and the Life Insurance Association of America agreed in 1963 that the basic objectives of the annual statement are so different in concept as to preclude the revision of the annual statement blank to conform to tax accounting concepts. II Proceedings of the National Association of Insurance Commissioners (1963), pp. 445–447.

to assets which, while compensating *numerically* for the overstatement, does not fully account for the related asset * * *." (Emphasis in original.)

Nor can the reference in Section 818(a) of the Code to the NAIC form provide the blanket adoption of NAIC accounting necessary to sustain petitioner's claim. The comprehensive detailed tax formulae set out in the substantive sections of Subchapter L preclude any assumption that Congress merely sought to adopt the NAIC form *in toto* into the taxing statute. Moreover, the legislative history of the Act makes clear that the NAIC form may only be used when "not inconsistent with the provision of the 1954 Code and an accrual method of accounting." H. Rep. No. 34, 86th Cong., 1st Sess., p. 42. Congress intended the NAIC annual statement to play only an interstitial part in the statutory structure for the taxation of life insurance companies, *i.e.*, that it is to be used only when it does not conflict with settled principles of tax accounting and that it never confers a deduction which the substantive provisions of the Code do not provide. Not only does Subchapter L fail to provide a deduction or exclusion with respect to loading, but petitioner's method in this instance falls short of meeting elementary accrual standards, for it would accrue the deferred and uncollected premiums for purposes of determining deductible and excludable reserves, but would not allow the accrual for the rest of the equation that determines petitioner's overall tax situation.

The opinion of the court below is in accord with the decision of the Court of Appeals for the Seventh

Circuit in *Franklin Life Insurance Co.* v. *United States,* 399 F. 2d 757, certiorari denied, 393 U.S. 1118, the only other appellate court holding on these issues.[10]

2. PREPAID AND CAPITALIZED INTEREST

Statement. By the terms of petitioner's policy loan agreements, a policyholder who borrows money from petitioner in connection with a specific life insurance policy is required to pay the interest "annually in advance" on the policy anniversary date. In the event that an insured does not pay the annual interest as required on the due date, the policy loan agreement requires that the interest be "capitalized" (added to the principal of the loan), bearing interest thereafter at the agreed upon rate. (Pet. 28a.)

Petitioner on its own records distinguished between interest deemed "earned" and interest deemed "unearned." Where the anniversary date of a policy securing a loan fell at some point in the year other than December 31, petitioner adjusted its records as of December 31 to show what portion of the interest it

[10] The only holding to the contrary is *Western National Life Ins. Co. of Texas* v. *Commissioner,* 51 T.C. 824, modifying 50 T.C. 285 wherein it has been held that "loading" should be subtracted in determining the amount of deferred and uncollected premiums included in the "assets" of life insurance companies in the "Phase I" computation under Section 805(b)(4). The *Western National* opinion, which reserves the question of treatment from the income side (Phase II), was discussed in supplemental memoranda filed with this Court by both the petitioner (Franklin) and the United States in *Franklin Life Insurance Co.* v. *United States, supra.* The final decision in *Western National* has recently been entered and will be subject to appellate review in the Court of Appeals for the Fifth Circuit.

deemed to have been "earned" during the taxable year and what portion it considered "unearned." If the annual interest was in default and had been added to the principal of the policy loan then, as of December 31, petitioner would prorate the capitalized interest as of December 31 to show the amount "earned" to that date. In the event that the policyholder repaid the principal of the loan during the policy year petitioner refunded the portion of the annual interest deemed "unearned" at that point to the policyholder; and where the amount deemed unearned had already been added to the policy loan principal, petitioner, in the event of repayment of principal, credited the policyholder with the "unearned" portion of such interest. (Pet. 28a.)

On its tax returns for the years in suit, petitioner, in computing its taxable investment income, sought to reflect only the interest it deemed "earned" as income, and to defer recognition as income of the remainder of the interest actually received or added to policy loan principal until the succeeding taxable year.[11] The district court disallowed petitioner's treatment and held that both the full amount of interest actually received and interest added to policy loan principal must be recognized as income in the years received or added to the principal. (Pet. 28a–29a.) The court of appeals affirmed.

Argument. Petitioner requires borrowers to prepay a year's interest on loans made against the cash value of the policies. If the advance interest has not been

[11] Petitioner offered no evidence as to any actual amounts ever refunded over the years. (Pet. 67a.)

paid on the anniversary date of the policy, and the available cash value exceeds the unpaid interest, petitioner capitalizes that interest by adding it to the principal of the policy loan.

Although a ratable refund of prepaid interest is made if part or all of the principal is repaid during the policy year, the loans have no due date and petitioner has no fixed or even predictable future liability to repay the prepaid interest. Thus, the interest which petitioner collects in advance belongs to it with no restrictions as to its use. Such amounts should be included in taxable investment income, for an accrual basis taxpayer must report in full amounts actually received by it under a claim of right during the taxable year, and this is so even when portions of those amounts represent payment for services rendered in a subsequent year (*Schlude* v. *Commissioner*, 372 U.S. 128) and despite the fact that the taxpayer later may be required to refund some of the money (*North American Oil* v. *Burnet*, 286 U.S. 417).

Similarly, there is no reason to omit any part of the capitalized interest in computing petitioner's income. The interest so added to principal of the policy loan itself bears interest at the same rate as the rest of principal. (Pet. 28a.) The same logic which requires the inclusion of interest received by petitioner in the year of receipt requires the inclusion of capitalized interest in the year capitalized.[12]

[12] Significantly, even the NAIC annual statement form (on which petitioner seeks to rely in connection with other issues) requires that the entire amount of interest capitalized during the year be reflected as assets of the life insurance companies.

The holding of the court below as to these issues is squarely in accord with the Seventh Circuit's holding in *Franklin, supra,* the only other appellate court to consider them,[13] and there is not, as petitioner urges (Pet. 3-2), a conflict between the decisions in this case and *Franklin,* on the one hand, and the decision in *Artnell Co.* v. *Commissioner,* 400 F. 2d 981 (C.A. 7). *Artnell* arose because a corporate reorganization and liquidation terminated the taxable year of the Chicago White Sox baseball team. The issue was whether the liquidated corporation should be required to report sales of tickets and other prepaid revenues related to future games when the later games were to be played by the successor corporation. Petitioner entirely fails to recognize that the Seventh Circuit did *not* hold that deferral of the prepaid income was proper. It merely remanded for further inquiry into the question whether (*id.,* p. 984) "the extent and time of future performance are so certain, and related items properly accounted for with such clarity, that a system of accounting involving deferral of prepaid income is found clearly to reflect income * * *". And this result must be viewed in the light of the peculiar fact that holders of tickets to unplayed games could secure refunds merely by demand.

In our view, *Artnell* was wrongly decided and reflects an improvident view of the Commissioner's authority to determine whether a method of account-

[13] The prepaid interest issue here is identical with that in *Franklin, supra. Franklin* also considered the treatment as an asset of the full amount of capitalized interest.

ing clearly reflects income. See Section 446 of the 1954 Code; compare *Schlude* v. *Commissioner, supra*; *American Automobile Ass'n* v. *United States*, 367 U.S. 687. There is not, however, a conflict, for there are multiple bases on which the two cases may be distinguished. For example, this case does not involve dual taxpayers or a pretermitted taxable year, and the contingencies that might cause restoration of the prepaid amounts are substantially different in nature. Compare *Commissioner* v. *Angelus Funeral Home*, 407 F. 2d 210 (C.A. 9).

The final outcome in *Artnell* will indeed not be entirely clear until the Seventh Circuit has a further opportunity to consider the *Schlude* rule in the light of whatever evidence is adduced upon remand to the Tax Court. Meanwhile, it is particularly noteworthy that the *Artnell* opinion does not even refer to the opinion in *Franklin*.[14]

3. AGENTS' DEBIT BALANCES

Statement. Agents' debit balances are the result of charges to the accounts of insurance agents made against future commissions. Jefferson did not make any cash advances to agents; Pilot, however, would advance money to its agents to provide for their living expenses until their commission income was sufficient to support them. Both Jefferson and Pilot also debited agents' accounts for various other charges: fees charged by reason of the cancellation or nondelivery

[14] The asserted conflict between *Franklin* and *Artnell* was also urged in the *Franklin* petition, which this Court denied.

of insurance policies within a specified time after they were written by the agent, charges for premiums on health and disability insurance on agents and their dependents, and, in the case of Jefferson, withholding taxes and charge-backs of commissions previously paid with respect to policies subsequently cancelled. (Pet. 29a.)

Although Jefferson, and apparently Pilot, had a contractual right to charge its agents interest on the amounts of the agents' debit balances, neither did so. When an agent terminated his connection with the company at a time when a debit balance existed in his account, Jefferson and Pilot would apply commissions to which the agent subsequently became entitled against the debit balances. Apart from such application, however, no attempt was made to collect any remaining balance, and the agent's uncollected debit balance would be charged to general insurance expenses. The large percentage of the debit balances of Pilot's agents represented amounts owed by agents who were still agents of Pilot at the end of the year, apparently, because Pilot made cash advances to them. The NAIC annual statement calls for the amount of agents' debit balances to be shown as a "non-admitted" asset, a phrase used to describe assets which are not considered in determining surplus for NAIC purposes. (Pet. 29a–30a.)

Petitioner asserts that its agents' debit balances are assets "used by it in carrying on an insurance trade or business," which the statute excludes from "assets" under Section 805(b)(4). Both the district

court and the court of appeals rejected this contention.

Argument. Section 805(b)(4) provides in pertinent part:

> (4) *Assets.*—For purposes of this part, the term "assets" means all assets of the company (including nonadmitted assets), *other than real and personal property (excluding money) used by it in carrying on an insurance trade or business.* * * * [Emphasis supplied.]

The question of statutory interpretation presented here is whether the agents' debit balances are "real and personal property (excluding money) used * * * in carrying on an insurance trade or business." These debit balances are in fact accounts receivable, representing advances to agents against future commissions.

The principal basis for petitioner's argument is an assumption that the phrase "used * * * in carrying on an insurance trade or business" should exempt whichever assets of petitioner are not productive of investment income. This assumption is contradicted not only by the broad language of Section 805(b)(4), which defines assets in terms of "all assets of the company," but by legislative history which plainly indicates that the test of includability of an asset for Section 805(b)(4) is not based upon whether it produces investment income. Rather, "all assets of the company," subject to a limited exception, are includible under Section 805(b)(4).

The purpose of the allocation of investment income under Section 804 is to divide investment income be-

tween a company's share and the policyholders' share. This is accomplished through a formula which essentially results in dividing up investment income in the ratio that assets held for policyholders, *i.e.*, reserves, bear to total company assets. Section 804, Internal Revenue Code of 1954. The argument that something less than total assets held for policyholders and total assets of the company are to be used—namely, only assets producing investment income—is negatived by the fact that the assets held or available for policyholder reserves are not restricted to those producing investment income but include assets other than those which are invested and producing investment income. The Phase I formula is not restricted to invested assets but encompasses an approach involving the *total* assets of the company and the portion thereof devoted to policyholder reserves.[15] H. Rep. No. 34, 86th Cong., 1st Sess., p. 12, fn. 1 to table, states: "The company's earnings rate actually is determined by dividing the company's 'investment yield' by its *total assets.*" (Emphasis supplied). Moreover, the Report emphasizes (H. Rep. No. 34, *supra,* p. 10):

> Making use of a company's actual earnings rate in arriving at the reserve deduction in effect allocates investment income between life insurance reserves and surplus, according to the *total amount* of each. [Emphasis supplied.]

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[15] Even the NAIC form recognizes as assets available for reserve purposes any number of assets neither of an invested nature nor producing investment income. See "Exhibit 13, Assets." (R. 593.)

As this history makes clear, Phase I determines the "earning rate *of the company* on its assets" (emphasis supplied) (S. Rep. No. 291, 86th Cong., 1st Sess., p. 2), rather than the earnings rate of selected investment assets.

The Treasury Regulations, Section 1.805-5(a)(4)(i), limit the assets excludable under Section 805(b)(4) to tangible assets such as home and branch office buildings, and land, furniture, supplies and stationery and other similar items used in the business.[16] This interpretation has explicit support in the legislative history. S. Rep. No. 291, *supra,* at p. 70. Under these circumstances, the court below properly upheld the validity of the administrative construction of Section 805(b)(4).[17]

4. CHARITABLE CONTRIBUTIONS

Statement. The total amount of petitioner's deduction for charitable contributions is not here in dispute. The issue is where they may be deducted. The government's position is that they must all be deducted as an expense in calculating operating income, under the terms of Section 809(d)(12) as modified by Section 809(e)(3). Petitioner contends that it need only deduct an allocable portion as an operating expense and that the remainder may be deducted as a general

[16] These Regulations expressly refer to agents' debit balances as an example of assets which are includible under Section 805(b)(4).

[17] The only other decision as yet on this point is in accord. *Western National Life Ins. Co. of Texas* v. *Commissioner,* 50 T.C. 285.

investment expense under Section 804(c)(1).[18] The court of appeals sustained the government's position.

Argument. The conclusion that the charitable contributions deduction is limited to Phase II (gain from operations) is at the outset indicated by the obvious fact that the only reference to such contributions in the Act is as a deduction under Section 809(d)(12) (as limited by Section 809(e)(3)), the section providing the deductions to be used for purposes of computing Phase II income. In addition, the limitations expressed in Section 809(e)(3) in respect of the amount of the allowable deduction are all based on items incident to the Phase II computation. The 5 percent of income limitation, which parallels the 5 percent limitation on contributions of ordinary corporations, is based entirely on Phase II income minus certain items specified in Section 809(d). Under established principles of statutory construction it may be concluded that Congress regarded the deduction as peculiar to Section 809, and thus to Phase II income.

5. BRANCH OFFICE MANAGER'S SUPPLEMENTAL RETIREMENT PLAN

Statement. Jefferson established a Branch Office Manager's Supplemental Retirement Plan in order to provide supplemental pension benefits to branch office managers. Under the plan, Jefferson made con-

[18] Since the ultimate tax base consist of investment income plus 50 percent of the excess of gain from operations over investment income, the deduction in Phase I (investment income) is worth more to petitioner than the same deduction in Phase II (gain from operations).

tributions based upon the employee's salary. Such contributions were not set apart or treated as separate funds but remained a part of the general corporate funds of Jefferson. If the employee reached the age of 65 while still in the employ of Jefferson, he was to receive an annuity to be calculated "on the basis of the net 1937 Male Standard Annuity Table with 3% interest." If the employee left Jefferson prior to age 65, died prior to age 65, or if Jefferson terminated his employment prior to that age, the employee had no right to any annuity or to any part of the Jefferson contributions to the plan. This was so regardless of the number of years the employee belonged to the plan. (Pet. 32a–33a.)

Jefferson did not issue any actual annuity contracts to branch office managers upon their inclusion in the plan. It did notify those employees of their rights under the plan and sent them annual reports of "contributions" made to the plan in their names. Jefferson expressly reserved an "absolute and unconditional" right to terminate the employment of members of the plan and also a right (subject to certain limitations) to terminate the entire plan. (Pet. 33a.)

The courts below rejected petitioner's claim that the amounts designed to fund petitioner's own Branch Office Manager's Supplemental Retirement Plan constitute life insurance reserves within the meaning of Section 801(b) of the 1954 Code.

Argument. As the court correctly found from the evidence, petitioner's "contributions" to the Branch Office Manager's Supplemental Retirement Plan were

not irrevocably dedicated to mature or liquidate future life insurance or annuity claims but could be invaded and used at the will of petitioner. Accordingly, they were not in the nature of life insurance reserves. *New York Life Ins. Co.* v. *Bowers*, 283 U.S. 242; *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U.S. 686; *General Life Ins. Co.* v. *Commissioner*, 137 F. 2d 185, 189–190 (C.A. 5).

Petitioner urges that such forfeitability "is a very common provision" in pension plans (Pet. 23–24). This may be true. Petitioner, however, has not claimed a deduction for pension plan reserves (having conceded that the amounts do not meet the statutory requirements for pension plan reserves). Rather it claims deductions on the ground that these amounts are true life insurance reserves for obligations under annuity contracts, a question entirely independent of ones that could arise under the pension trust provisions of the Internal Revenue Code, Sections 401 *et seq.*

6. DETERMINATION OF CONSOLIDATED TAXABLE INCOME

Statement. Jefferson, prior to 1958, acquired by purchase all of the outstanding stock of Pilot, another life insurance company. During each of the years 1958 and 1959, Pilot paid cash dividends to Jefferson out of current earnings and profits in the amount of $1,250,000. For the years 1958 and 1959, these companies filed consolidated income tax returns. In both returns, Jefferson and Pilot were treated as a single taxable entity. At every step in the computations re-

quired to determine the Phase I and Phase II taxable investment income, the figures of both companies were consolidated on an item-by-item basis, and there were eliminated from all computations Jefferson's investment in the Pilot stock, together with the dividends paid by Pilot to Jefferson. (Pet. 6a.)

The Government contended below that the method Jefferson and Pilot utilized on their consolidated income tax returns was improper, and that it was necessary to compute separately the excluded "policyholders' share" of investment income for Pilot and Jefferson, taking into account in the Jefferson computation the Pilot stock as an "asset" and the dividends thereon as "income." After the computation of the "policyholders' share" for each company and the incident ascertainment of the company's share of each, the companies' shares would be added together to produce consolidated investment yield and the policyholders' shares would be added together to produce the excludable policyholders' share of consolidated investment yield. Upon consolidation the dividend income received by Jefferson and Pilot, which is not excluded through Jefferson's policyholders' share, would be eliminated from consolidated investment yield. (Pet. 50a–52a.)

The courts below agreed with the Government.

Argument. The decision below is correct and in accord with this Court's opinion in *United States* v. *Atlas Life Ins. Co.*, 381 U.S. 233.

Both Section 804(a)(1) and Section 809(a)(1) provide for the exclusion from the tax base of a life

insurance company of that portion of investment income (called the "policyholders' share") deemed a necessary addition to the company's reserve for policyholders. The exclusion is arrived at by application of the statutory formula to the mean reserves, assets, earnings, and interest assumptions of each individual life insurance company. In light of the fact that tax-exempt dollars are as fully available as taxable dollars in the satisfaction of reserves requirements, Section 804 and Section 809 specifically require that exempt items such as interest on state and municipal bonds initially must be taken into account in computing the excluded "policyholders' share." The tax-exempt character of such income subsequently is recognized by deducting from the tax base that portion which is allocated to the taxable "life insurance company's share" of investment income. This Court held in *United States* v. *Atlas Life Ins. Co., supra,* that the statutory method did not result in the imposition of tax on tax-exempt interest.

The essence of the *Atlas* decision is that the amount excluded as the policyholders' share constitutes a measurement (for tax purposes) of the claim of each company's policyholders against its investment income. The life insurance company thus receives special and substantial tax relief based upon the concept of the division of its income with its own policyholders. Incident to this benefit is the requirement that the computation take into account all the investment income and assets to which the policyholders of the individual company may look. The method petitioner ad-

vances removes from consideration Jefferson's investment in Pilot, even though that is an *asset,* a pro rata portion of which is deemed part of Jefferson's reserves, and dividends, a portion of which (under *Atlas*) are deemed earned for Jefferson's policyholders. This is not a proper measurement of what Jefferson has available to respond to its liabilities to policyholders. The result would be, as here, that petitioner's consolidated policyholders' share exclusion under Phase I does not equal the sum of the policyholder exclusions of Jefferson and Pilot computed separately (R. 81–82). Thus, it is apparent that the total liability of petitioner vis-à-vis policyholders of Jefferson and Pilot (the contracts of which run separately to each company) is not correctly stated, and that it can be stated correctly only if each company's obligations to its own policyholders are treated separately.

Petitioner repeatedly argues (Pet. 33–39) that the Treasury Regulations with respect to consolidated income tax returns—which antedate the 1959 Act—require a different result. This is not so. Section 1.1502–31A(a), defines consolidated taxable income as the combined taxable income of the affiliated corporations. Section 1.1502–31A(b)(1) says that the taxable income of each corporation shall be computed in accordance with the provisions covering the determination of taxable income of separate corporations except that "(i) There shall be eliminated * * * dividend distributions from one member of the group to another member of the group * * *." Of course, this means

that the Pilot dividends are to be "eliminated". But this does not resolve the question of *how* to eliminate them and from *what*. The consolidated return provisions do not speak to this point. Rather, Section 1.1502–3A goes on to provide that any matters in the determination of which the Regulations "are not applicable shall be determined in accordance with the provisions of the Code or other law applicable thereto." (Pet. 7a.) The consolidated return provisions, therefore, simply show that the dividends are a type of tax-exempt income. The consequence of this determination for a life insurance company was given by this Court in the rationale of *Atlas*.

7. THE APPLICABLE RATE OF TAX

Statement. Jefferson elected to file consolidated income tax returns with Pilot, its wholly-owned subsidiary, for the years 1958 and 1959. It computed its tax according to the rates specified in the corporate income tax returns for life insurance companies (Form 1120L) upon which it was required to report its income. (Pet. 20a.) Those rates were two percent higher for life insurance companies filing consolidated returns than for life insurance companies filing separate returns. Subsequently, however, petitioner took the position that life insurance companies are entitled to file consolidated returns without payment of the two percent higher rate. The issue was resolved against petitioner by the district court and the court of appeals. (Pet. 20a.)

Argument. The decision below is correct. Section

802(a) of the 1954 Code provides that a tax "is hereby imposed" on life insurance companies which is to consist of the normal tax "computed" at the rate specified in Section 11(b) and the surtax "computed" at the rate specified in Section 11(c). Section 1503 provides that where a consolidated return is made, the tax "imposed under section 11(c)" shall be increased by two percent. Accordingly, the crux of the issue is whether the tax "imposed" by Section 802 is to be "computed" at the rate provided by Section 11 (c), as modified by Section 1503, even though the latter section speaks of a tax "imposed *under*" Section 11(c).

Significantly, Section 11(a), which "imposes" a tax on other corporations, has the same structure as Section 802(a), *i.e.*, the tax which it imposes is "computed" under Section 11(b) and Section 11(c). Accordingly, Section 11(c) *never*, by itself, imposes a tax on the income of any corporation. Thus, when Section 1503 increases the tax "imposed under section 11(c)," it either refers to all taxes *computed* under Section 11(c) or it is a nullity.

This interpretation is supported by the structure and legislative history of the 1959 Act evidencing the intention of Congress that the unique tax treatment of life insurance companies should stop with the determination of the tax base. Once that base was arrived at, life insurance companies were to be taxed at the same rates as other corporations. H. Rep. No. 34, 86th Cong., 1st Sess., p. 23; S. Rep. No. 291, 86th

Cong., 1st Sess., p. 44; S. Rep. No. 291, 86th Cong., 1st Sess., p. 127 (Supplemental Views on H.R. 4245).[19]

There is no conflict as to this unique legal issue, and the number of life insurance companies filing consolidated returns is believed to be minimal. Finally, and of particular importance here, the issue lacks vitality—the additional two percent tax was eliminated as to all corporations for taxable years beginning after December 31, 1963, by Section 234(a), Revenue Act of 1964, P.L. 88-272, 78 Stat. 19.

8. THE NAIC COMPUTATIONS

Argument.

1. Petitioner also seeks to present the broad assertion that deductions and computations required on the annual statement form promulgated by the National Association of Insurance Commissioners are controlling under Subchapter L and may be used indiscriminately for tax purposes. As we have shown above—in our discussion of the treatment of deferred and uncollected premiums—the NAIC rules are designed to serve a purpose that is not fully compatible with the

[19] Petitioner's suggestion that the decision is somehow "contrary to a longstanding administrative interpretation of Section 1503(a)" is wrong. Petitioner's objection (Pet. 39–40) is apparently to a sentence in the opinion to the effect that the additional tax "increased" the surtax. Petitioner states that the increase is considered an "addition" to the surtax, not an increased surtax. Section 1503(a) states that the surtax "shall be increased" by the additional tax, and the court merely used the same language as the statute. That the "increase" is considered to be an "addition" for the purposes of the $25,000 surtax exemption has no bearing on the issue here and is nowhere contradicted in the court's opinion.

needs of tax accounting. Thus, the NAIC is not interested in reflecting earnings in a fashion that satisfies the needs of an income tax statute. Its design rather is regulation that helps guarantee the financial integrity of the insurance companies in order to safeguard the interests of the policyholders. To achieve this objective, the NAIC uses purposely stringent and conservative standards, having as their objective the identification of the minimum amount of quick assets that would be available to satisfy the policyholder claims in the event of insolvency.

The necessary result is a conscious understatement—indeed, a minimization—of income and assets in the NAIC statement. Of course, it would be advantageous for petitioner and other insurance companies to use the NAIC rules wherever possible in order to minimize their federal income tax liabilities. But that is not what the income tax statute allows. The critical provision, Section 818(a), provides:

> * * * All *computations* entering into the determination of the taxes imposed by this part shall be made—
>
> (1) under an *accrual* method of account, or
>
> (2) to the extent permitted under regulations prescribed by the Secretary or his delegate, under a combination of an accrual method of accounting with any other method permitted by this chapter (other than the cash receipts and disbursements method).
>
> *Except as provided* in the preceding sentence, all such computations shall be made in a manner consistent with the manner required for pur-

> poses of the annual statement approved by the National Association of Insurance Commissioners. [Emphasis supplied.]

Thus, Section 818(a) does not purport to grant deductions over and above those authorized in the detailed substantive provisions setting out the tax formulae. Even where a deduction is there authorized, the use of a computation from the NAIC form is subordinated to (1) the rules of accrual accounting for tax purposes,[20] and (2) Treasury Regulations setting forth "a combination of an accrual method of accounting with any other method permitted by this chapter (other than the cash receipts and disbursements method)." For these purposes, each issue under Subchapter L, and all pertinent Regulations, must be examined for its own worth. They cannot, as petitioner suggests, all be lumped together. All that is necessary for present purposes is that, as we have shown, the Regulations that apply to this case are reasonable rules within the context of the statute.

2. Petitioner cannot seriously argue, as it now seemingly attempts (Pet. 26–28), that there is a conflict between courts of appeals as to the meaning of the reference to the NAIC computations in Section 818(a). In support of its position, petitioner cites a past conflict of authority in respect of the weight to

[20] To the same effect are Treasury Regulations (Section 1.818–2(a)(1)):

"* * * Except as otherwise provided in part I, the term 'accrual method' shall have the same meaning and application in section 818 as it does under section 446 (relating to general rule for methods of accounting) and the regulations thereunder."

be given a reference to the NAIC Annual Statement in Section 204 of the Internal Revenue Code of 1939, which dealt with the determination of casualty insurance company taxes and not with life insurance companies.[21] That section, in contrast to the subordinating reference to NAIC computations in Section 818(a), specifically provided that the income of such companies was to be "computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners * * *". The statute defining the income tax liabilities of casualty companies said very little else, and unlike the detailed formulae encompassed in the 1959 Life Insurance Company Act, furnished little or no guidance with respect to the items to be taken into account for tax purposes. The First Circuit in *Commissioner* v. *New Hampshire Fire Ins. Co.*, 146 F. 2d 697, held that the casualty companies were entitled to rely completely on the NAIC convention blank with respect to the computation of certain reserves for tax deduction purposes. The Fourth Circuit in a *per curiam* opinion in *United States* v. *Fidelity & Deposit Co. of Maryland*, 177 F. 2d 805, citing *Commissioner* v. *New Hampshire Fire Ins. Co., supra*, also held the statutory language strong enough to make the NAIC convention form controlling. Thereafter, the Second Circuit in *Commissioner* v. *General Reinsurance Corp.*, 190 F. 2d 148,

[21] The substance of Section 204 is incorporated in Section 832(b)(1) of the 1954 Code, which is *not* part of the Life Insurance Company Income Tax Act of 1959.

certiorari dismissed, 342 U.S. 863, and the Ninth Circuit in *Pacific Ins. Co.* v. *United States,* 188 F. 2d 571, certiorari dismissed, 342 U.S. 857, reached the opposite conclusion, refusing to recognize the NAIC treatment of the reserve items in question despite the statutory language and the abbreviated form of the statute.

These cases, however, have nothing to do with this case. The statute applying to life insurance companies is in marked contrast to the casualty company statute discussed. It spells out in great detail the precise formulae for the computation of taxes. Both in *Franklin* and here, it has been agreed that life insurance companies must look to the statute and Regulations for deductions, not the NAIC form. This is plainly correct, whatever may be true of the taxation of casualty companies.

9. THE SIGNIFICANCE OF THIS CASE

Petitioner argues that review of the issues raised would provide "an opportunity * * * to answer the most troublesome questions of interpretation under the Life Insurance Company Income Tax Act of 1959" (Pet. 14). The apparent implication is that review of this case would clear the air for the settlement of life insurance company tax liabilities in a large number of pending cases. Unfortunately, this is not so. The courts of appeals are yet to experience any difficulty with the particular eight issues involved in petitioner's case. There are presently pending in dispute, upon audit of

the ten largest life insurance companies alone, over one hundred independent issues under the 1959 Act, exclusive of those involved here. Although petitioner has sought to chart claimed similarities in issues in cases which have reached the litigation stage (Pet. 18), its thesis depends entirely on its view that 20 different issues may be considered as one because they all involve the NAIC form. Equally important, petitioner has neglected to point out the large number of additional issues in dispute in the very cases it charts.[22] Thus, the tax liabilities involved in most of the cases listed would not be settled by review of the particular issues involved in this petition. Significantly, petitioner's pending suit for refund of taxes for 1960 (*Jefferson Standard Life Ins. Co.* v. *United States* (M.D. N.C., Civ. No. C–84–C–66)) involves at least seven issues not raised here. Accordingly, review of the instant case would not even settle petitioner's own tax liability for its next taxable year.

Under these circumstances, and in the continued absence of a conflict in the appellate courts, review of all or any of the particular issues raised would not make a major contribution from the standpoint of facilitating orderly administration of the tax laws.

[22] For instance *National Life & Accident Ins. Co.* v. *United States* (M.D. Tenn., Civ. No. 4995), cited for three similar issues, involves eight issues not in litigation here; *Old Reliance Ins. Co.* v. *United States* (Ct. Cl., No. 324–68) involves four more, and *Southwestern Life Ins. Co.* v. *United States* (N.D. Tex., Civ. No. 3–3003–A), an additional three.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954:

SEC. 809 [as amended by Sec. 2(a), Life Insurance Company Income Tax Act of 1959, 73 Stat. 112, 122]. IN GENERAL:

* * * * *

(d) *Deductions.*—For purposes of subsections (b) (1) and (2), there shall be allowed the following deductions:

(1) *Death benefits, etc.*—All claims and benefits accrued, and all losses incurred (whether or not ascertained), during the taxable year on insurance and annuity contracts (including contracts supplementary thereto).

(2) *Increases in certain reserves.*—The net increase in reserves which is required by section 810 to be taken into account for purposes of this paragraph.

(3) *Dividends to policyholders.*—The deduction for dividends to policyholders (determined under section 811(b)).

(4) *Operations loss deduction.*—The operations loss deduction (determined under section 812).

(5) *Certain nonparticipating contracts.*—An amount equal to 10 percent of the increase for the taxable year in the reserves for nonparticipating contracts or (if greater) an amount equal to 3 percent of the premiums for the taxable year (excluding that portion of the premiums which is allocable to annuity features) attributable to nonparticipating contracts (other than group contracts) which are issued or renewed for periods of 5 years or more. For purposes of this paragraph, the term "reserves for nonparticipating contracts" means such part of the life insurance reserves (excluding that por-

tion of the reserves which is allocable to annuity features) as relates to nonparticipating contracts (other than group contracts). For purposes of this paragraph and paragraph (6), the term "premiums" means the net amount of the premiums and other consideration taken into account under subsection (c)(1).

(6) *Group life, accident, and health insurance.*—An amount equal to 2 percent of the premiums for the taxable year attributable to group life insurance contracts and group accident and health insurance contracts. The deduction under this paragraph for the taxable year and all preceding taxable years shall not exceed an amount equal to 50 percent of the premiums for the taxable year attributable to such contracts.

(7) *Assumption by another person of liabilities under insurance, etc., contracts.*—The consideration (other than consideration arising out of reinsurance ceded) in respect of the assumption by another person of liabilities under insurance and annuity contracts (including contracts supplementary thereto).

(8) *Tax-exempt interest, dividends, etc.*—

(A) *Life insurance company's share.*—Each of the following items:

(i) the life insurance company's share of interest which under section 103 is excluded from gross income,

(ii) the deduction for partially tax-exempt interest provided by section 242 (as modified by section 804(a)(3)) computed with respect to the life insurance company's share of such interest, and

(iii) the deductions for dividends received provided by sections 243, 244, and 245 (as modified by subparagraph (B)) computed with respect to the life insurance company's share of the dividends received.

(B) *Application of section 246(b).*—In applying section 246(b) (relating to limitation on

aggregate amount of deductions for dividends received) for purposes of subparagraph (A)(ii), the limit on the aggregate amount of the deductions allowed by sections 243(a), 244, and 245 shall be 85 percent of the gain from operations computed without regard to—

(i) the deductions provided by paragraphs (3), (5), and (6) of this subsection,

(ii) the operations loss deduction provided by section 812, and

(iii) the deductions allowed by sections 243(a), 244, and 245,

but such limit shall not apply for any taxable year for which there is a loss from operations.

(9) *Investment expenses, etc.*—Investment expenses to the extent not allowed as a deduction under section 804(c)(1) in computing investment yield, and the amount (if any) by which the sum of the deductions allowable under section 804(c) exceeds the gross investment income.

(10) *Small business deduction.*—A small business deduction in an amount equal to the amount determined under section 804(a)(4).

(11) *Certain mutualization distributions.*—The amount of distributions to shareholders made in 1958 and 1959 in acquisition of stock pursuant to a plan of mutualization adopted before January 1, 1958.

(12) *Other deductions.*—Subject to the modifications provided by subsection (e), all other deductions allowed under this subtitle for purposes of computing taxable income to the extent not allowed as deductions in computing investment yield.

Except as provided in paragraph (3), no amount shall be allowed as a deduction under this subsection in respect of dividends to policyholders.

* * * * *

(26 U.S.C. 1964 ed., Sec. 809.)

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